In the Matter of)	
)	
Application of Verizon New England Inc.,)	
Bell Atlantic Communications, Inc. (d/b/a)	
Verizon Long Distance), NYNEX Long Distance)	CC Docket No. 01-9
Company (d/b/a Verizon Enterprise Solutions),)	
And Verizon Global Networks Inc.,)	
For Authorization to Provide In-Region,)	
InterLATA Services in Massachusetts)	

DECLARATION OF RICHARD N. CLARKE
ON BEHALF OF AT&T CORP.

Based on my personal knowledge and on information learned in the course of my

duties, I, Richard N. Clarke, declare as follows:

1.　　My name is Richard N. Clarke. My business address is 295 North Maple

Avenue, Basking Ridge, NJ 07920.

2.　　I am employed by AT&T Corp. ("AT&T") as a Division manager in

AT&T's Law and Government Affairs organization. In this position I am responsible for

AT&T's economic policies related to the costing and pricing of local telecommunications

services. I have directed AT&T's investigations into the structure of efficient pricing methods

for telecommunications elements and services and AT&T's participation in the development of

the HAI/Hatfield Model of forward-looking economic costs of local exchange networks and

services. I also have experience in evaluating other local exchange costing models and

methodologies such as the BCPM and the Federal Communications Commission's

("Commission's") Synthesis Model.

3.   I have a Bachelor's degree in mathematics and economics from the
University of Michigan and a Master's degree and a Ph.D. in economics from Harvard. Prior to
joining AT&T with Bell Laboratories in 1986, I was an Assistant Professor of Economics at the
University of Wisconsin-Madison, and worked as an Economist in the Antitrust Division of the
U.S. Department of Justice.

4.   Over the past dozen years, I have provided testimony before numerous
regulatory commissions, including those of Texas, Wisconsin and this Commission, among
others. Much of this testimony has dealt with economic, costing and pricing issues related to
local exchange competition.

I.   INTRODUCTION AND SUMMARY

5.   The purpose of my declaration is to demonstrate that the pricing of
interconnection and unbundled network elements ("UNEs") is of critical importance in making
possible widespread competitive entry into local exchange markets. Furthermore, even modest
overstatements in the pricing of interconnection and UNEs are likely to have profound import for
whether competitive entry will occur at all – or whether even existing competitive entries by
competitive local exchange carriers ("CLECs") will be sustained.

6.   Although the critical importance of pricing has always been well-known to
economists and businesspeople, this declaration demonstrates empirically the financial
significance that even modest overstatements of input prices would have for typical firms in the
U.S. economy. In particular, even a 10% reduction in a firm's net revenues (as would occur if
the price of a firm's purchased inputs that comprise two-thirds of its revenues were inflated by
15%) would virtually *eliminate* the profits (returns on equity or returns on debt plus equity)
earned by the average firm in the Standard & Poor's 500 Index. Indeed, the average firm in the

S&P 500 would also see its EBIT or EBITDA margins cut roughly in half by such an occurrence.[1]

7.   Thus, it is essential that rates for interconnection and UNEs be set accurately at their Total Element Long-Run Incremental Cost ("TELRIC") because, as the Commission has previously recognized, UNE prices based on forward-looking, economic costs are critical for the development of UNE-based competition in the local exchange market.[2] Any assumption that full and accurate compliance with the TELRIC standard is of secondary importance, and that wide competitive entry can be expected to occur as long as UNE prices are within a "range" of TELRIC compliance, is completely unfounded. Even slight overstatements of UNE rates above TELRIC levels severely impede competition across local exchange markets.

8.   Because the costs associated with purchased UNEs typically represent at least 70 percent of the total revenues (including access, vertical features and other incidental revenues) that a CLEC can expect to receive as a UNE-based provider of local exchange and

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[1] EBIT measures Earnings Before Interest and Taxes; EBITDA measures Earnings Before Interest, Taxes, Depreciation and Amortization.

[2] *See, e.g., Implementation of the Local Competition Provisions of the Telecommunications Act of 1966*, First Report and Order, 11 FCC Rcd. 15499, ¶ 679 (1996), *aff'd in part and vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999) (stating that adopting a pricing methodology based on forward-looking, economic costs "simulates the conditions in a competitive marketplace" and "allows the requesting carrier to produce efficiently and compete effectively, which should drive retail prices to their competitive levels"); *Application of Ameritech Michigan Pursuant to Section 271 to Provide In-Region, InterLATA Services in Michigan*, 12 FCC Rcd. 20543, ¶ 287 (1997) ("Determining cost-based rates has profound implications for the advent of competition in the local markets and for competition in the long-distance market. Because the purpose of the checklist is to provide a gauge for whether the local markets are open to competition, we cannot conclude that the checklist has been met if the prices for interconnection and unbundled elements do not permit efficient entry").

exchange access services,[3] each one percent overstatement in UNE prices reduces a CLEC's "top-line" net revenues by more than 0.7 percent. Thus, a 15 percent overstatement in UNE prices reduces the net revenues available to CLECs by at least 10 percent. Moreover, because the potential margins from UNE-based competitive entry are narrow, a 15 percent overstatement in UNE prices (*i.e.*, at least a 10 percent increase in CLEC costs) is likely to eliminate the potential for any profit from competitive entry by most CLECs in most markets.

9. Input cost overstatements of this magnitude necessarily trigger significant reactions by CLECs. Because a BOC's prices for its retail services effectively impose a cap on the price that any CLEC can charge for providing competitive local telephone service, CLECs cannot engage in the typical response of firms faced with an increase in input prices: charging higher retail prices. In consequence, the effect of even relatively modest increases in UNE prices will be effectively to bar CLECs from entering local markets or to cause them to provide service only to the highest margin segments of those markets. This competitive reality is illustrated by recent developments in local exchange markets where potential CLECs are declining entry altogether or restricting their offerings only to certain classes of customers such as business customers or only extremely high volume or low-cost residence customers,[4] and are even cutting back on their marketing of existing the local exchange offerings.[5] Although all local markets in

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[3] *See* WorldCom *Ex Parte* letter to Magalie Roman Salas in CC Docket No. 01-9, dated February 14, 2001, at 13. Indeed, 70 percent is a very conservative figure. Unfortunately, it is more typical to find UNEs priced at levels that amount to 90 percent (and sometimes more) of a CLEC's potential revenues.

[4] Z-Tel, for example, targets only a "niche" market, offering bundled packages of local, long-distance, and enhanced services (such as voice-mail and internet functions). *See* http://www.myzline.com/products/pricing_map.jsp?state=Massachusetts&from=, offering packages of residential service only at monthly rates in the $50 to $60 range.

[5] For example, Sprint recently announced its withdrawal from marketing local UNE-P based service to residential customers in New York. *See, e.g.,* F. Williams, "Residential Phone

the nation will be affected by overstated UNE prices, the most severe competitive impact is likely to occur in residential and rural local exchange markets, where profit margins are lower than for business and urban residential customers.

II. AN OVERSTATEMENT OF UNE PRICES ABOVE TELRIC LEVELS SERIOUSLY IMPEDES COMPETITIVE ENTRY.

10. Inflated prices for UNEs reduce the net revenues (*i.e.*, gross revenues minus purchased input costs) received by CLECs. The question is whether the reduction in net revenues occasioned by even a modest overstatement of prices above TELRIC levels is likely to damage CLECs' profitability to the point that CLEC entry into local exchange markets is effectively precluded. It is a truism that in a perfectly competitive market, even a dollar's increase in the price of inputs above cost that is specific to a certain class of firms (*i.e.*, unintegrated CLECs), and that is not also experienced by a different class of firms (*i.e.*, integrated ILECs), would cause unintegrated CLECs not to enter a market, or if already present, eventually to exit. Nonetheless, it is useful to illustrate the impact of varying levels of input-price increases on the financial condition of CLECs and for large firms more generally.

11. Even though the financial condition of particular CLECs may not be sufficiently ascertainable that the effect of imposing an unwarranted increase in their input prices

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Competition Disconnecting," *The Buffalo News*, February 11, 2001, p. 13B. AT&T has scaled back the scope of its UNE-P entry efforts in New York and Texas, and stated that efforts to gain new UNE-P customers would cease unless state regulators lowered rates for UNE-P elements to true TELRIC levels. *See* Speech by C. Michael Armstrong to the National Press Club on February 7, 2001, at 4 (available at http://www.att.com/speeches/item/0,1363,3662,00.html). Earlier, numerous CLECs, such as AT&T and MCI, ceased offering local service through resale because the wholesale discount is inadequate for a reseller to make a profit on the service. And even Verizon has now shelved its OneSource plan under which it used interconnection services purchased from other incumbent LECs to provide packages of local and long distance service to 370,000 subscribers outside of its franchised monopoly territories (*see* E. Douglass, "Verizon to Pull Plug on OneSource Service Plan," *Los Angeles Times*, February 26, 2001 Page C-1).

can be directly calculated until after they cease operations, such a calculation can be performed

for the typical large firm in U.S. industry whose financial data are easily available.[6] I do this by

examining the financial data reported by the firms comprising the S&P 500 (as reported by

Compustat), to evaluate how a decrease in the net revenues of these companies by specified

percentages would affect their financial positions.[7] Note that because the firms selected to be

included in the S&P 500 list are among the most stable and financially strong in the U.S.

economy, the financial consequences to the CLECs from an equivalent increase in their input

prices are likely to be far more dire.

> 12.   Table 1 demonstrates the financial effects of declines of 0%, 5%, 10%,

15% and 20% in the net revenues of the S&P 500 firms – which would result if, assuming that

input costs amount to two-thirds of these firms' gross revenues, input prices were elevated by

0%, 7.5%, 15%, 22.5% and 30%, respectively, and these firms had no flexibility to raise their

retail prices in response.[8]

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[6] The financial condition of a particular CLEC is often difficult for an "outsider" to determine, for a variety of reasons. For example, the CLEC may be privately owned, or may have obtained its financing through private sources. Information on other factors that affect a CLEC's financial condition, such as the amount of goodwill and the CLEC's contractual obligations, may not be publicly available.

[7] Compustat, a division of Standard & Poor's, collects annually a wide selection of data on the major firms in the United States economy.

[8] Microsoft Excel software collecting the Compustat data and performing these financial calculations was developed for AT&T by The Brattle Group of Cambridge, Massachusetts.

Table 1: Returns to the Total S&P 500

| Average Return Measure	Decline in Net Revenue of:				
	0%	5%	10%	15%	20%
EBT Margin	13.1%	8.5%	3.4%	-2.3%	-8.7%
Return on Equity+Debt	12.7%	7.6%	2.5%	-2.6%	-7.7%
Return on Equity	17.4%	9.0%	0.5%	-7.9%	-16.3%
EBITDA Margin	22.7%	18.6%	14.1%	9.1%	3.4%
EBIT Margin	16.7%	12.3%	7.5%	2.0%	-4.1%

Source: Compustat Database, Year-end 1999

13. Table 1 shows that if a S&P 500 firm's net revenues are reduced by 5% (as would occur if input prices amounting to two-thirds of its gross revenues were elevated by 7.5%), its initial return on Equity+Debt of 12.7% would be reduced by 40% (or over 500 basis points) to a new return level of 7.6%.[9] An overstatement of input prices of just 10% (corresponding to a 6.7% reduction in net revenues if purchased inputs amount to two-thirds of the firm's gross revenues) results in a reduction in the Return on Equity+Debt by more than in half from its base value. If the input cost increase is sufficient to reduce net revenues by 10%, Return on Equity+Debt is cut by 80% (or over 1000 basis points) to a new return level of only 2.5%.

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[9] The return measure most comparable to that popularly examined by regulators is Return of Equity+Debt. While not exactly equaling the Return on Ratebase ("ROR") measure that is the focus of most regulatory proceedings, this measure tends to be similar in magnitude to regulatory ROR and, most importantly, is likely to vary similarly with ROR as net revenues are reduced.

Return Plummets as a Firm's Net Revenue Declines
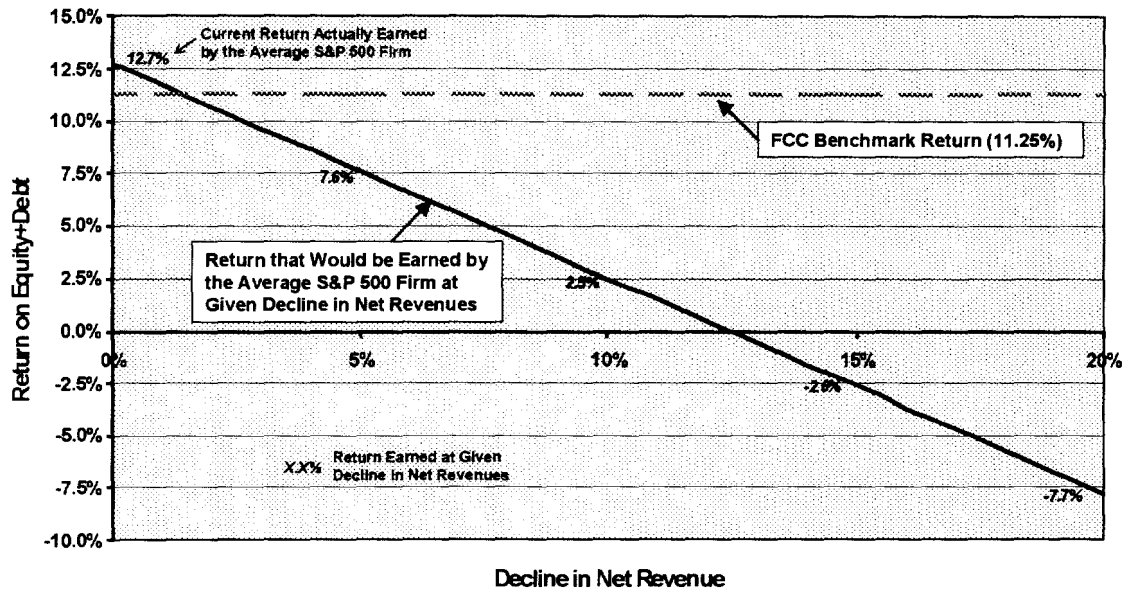
14. Furthermore, as shown in Table 2 below, a net revenue reduction of 10%

(as would occur if input prices amounting to two-thirds of the firm's gross revenues were

elevated by 15%) is sufficient to ensure that almost 9 out of every 10 firms in the S&P 500

would have a Return on Equity+Debt that is less than 11.25%.[10]

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[10] In its Universal Service, Price Cap and ROR Prescription proceedings, the Commission found 11.25% to be the target ROR for ROR-regulated ILECs and for Universal Service provision, and a return of 10.25% to be the minimum ROR that a price cap-regulated ILEC must be earning before being awarded a rate increase. Thus, even an input price overstatement that reduces a CLEC's net revenues by only 5% would be sufficient to cause the Commission's rules to offer an upwards rate adjustment or support increase – if the affected party was a monopoly ILEC.

Table 2: **Return on Equity+Debt in the Total S&P 500**

		Decline in Net Revenue of:				
Return on Equity+Debt		*0%*	*5%*	*10%*	*15%*	*20%*
No. of Firms with Returns:	< 11.25%	227	338	395	418	427
No. of Firms with Returns:	> 11.25%	218	107	50	27	18
	Total No. of Firms	445	445	445	445	445

Note: Required data are missing for 55 firms. Total sample size = 445 firms.
Source: Compustat Database, Year-end 1999

Percent of S&P 500 Firms that Would Earn Under 11.25
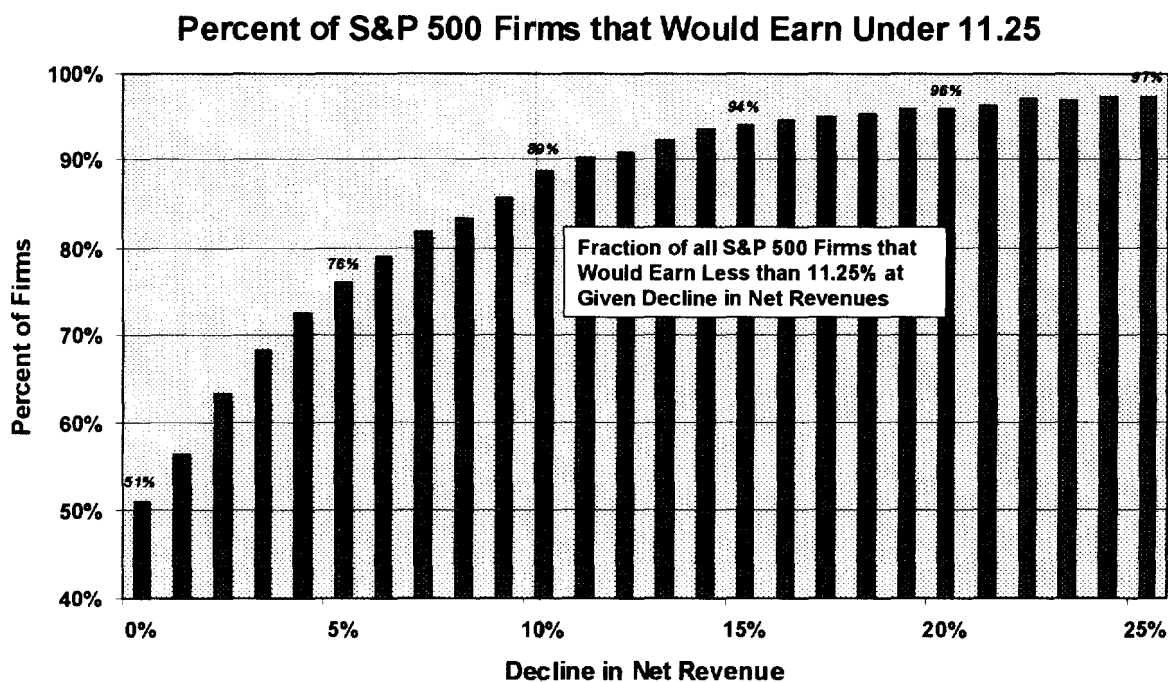
15. Given the magnitude of the deterioration in financial position that results from these moderate declines in net revenues, it is clear that a permanent overstatement of input

costs of as little as 5% or 10% would cause either the immediate bankruptcy or imminent restructuring of most firms in the S&P 500. Because most CLECs are less well capitalized than the firms that comprise the S&P 500, the financial deterioration that they would suffer from comparably elevated input prices would be even more severe – and their market exit would be even more speedy and complete.

16. As detailed in Table 1, an examination of other measures of financial status suggest the same result. One such measure is Earnings Before Interest, Taxes divided by Net Sales (EBIT margin). EBIT margin indicates the cash flow that is generated before interest and taxes are paid. Because interest and tax payments are mandatory for a going firm, EBIT margins must be sufficient to cover these expenses. When net revenues are reduced by 10%, EBIT margins decline by 920 basis points for the entire S&P 500 and by 820 basis points for the ILEC members of the S&P 500.[11] Even under the "rosiest" measure of financial performance – Earnings Before Interest, Taxes, Depreciation and Amortization divided by Net Sales (EBITDA margin) – a modest decline in net revenues spells significant financial damage.[12] For CLECs and other nascent firms that rely heavily on debt financing, declines of either magnitude would severely injure their ability to secure any debt financing, or to service existing debt.

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[11] Table 1 shows that the average firm in the S&P 500 has an EBIT margin of 16.7%. However, as shown in Table 3 below, the firms in the S&P 500 that are predominantly incumbent local exchange carriers (Alltel, BellSouth, CenturyTel, Qwest, SBC and Verizon) have average EBIT margins of 26.3%, because the local exchange industry is both profitable and capital-intensive.

[12] EBITDA margin indicates the maximum cash flow that is generated before non-operating expenses are considered.

Table 3: Returns to the ILECs in the S&P 500

	Decline in Net Revenue of:				
Average Returns Measure	*0%*	*5%*	*10%*	*15%*	*20%*
EBT Margin	21.2%	17.1%	12.5%	7.3%	1.5%
Return on Equity+Debt	13.5%	11.1%	8.6%	6.2%	3.8%
Return on Equity	32.3%	23.1%	13.9%	4.7%	-4.5%
EBITDA Margin	44.0%	41.1%	37.8%	34.1%	30.0%
EBIT Margin	26.3%	22.4%	18.1%	13.3%	7.9%

Source: Compustat Database, Year-end 1999

17.   Moreover, analyses of the effects of such declines in net revenues on the S&P 500 ILECs greatly understate the likely financial impact on the CLECs. The ILECs in the S&P 500 are among the most heavily and conservatively capitalized, and financially strong companies in the entire U.S. economy. By contrast, due to their market position as insurgents, CLECs are typically far less well capitalized, more reliant on aggressive debt financing, and less financially strong than the ILECs. Indeed, there are no "pure" CLECs that have the financial status to yet qualify to be members of the S&P 500.

18.   Perhaps the best set of CLEC-surrogate firms that are members of the S&P 500 are non-ILEC telecommunications carriers. These companies include cellular carriers, cable television carriers and interexchange carriers (AT&T, Comcast, Global Crossing, Nextel, Sprint FON, Sprint PCS, and WorldCom). Because of these firms' incumbent positions in their non-CLEC cellular, cable or interexchange markets, they also are likely to be much more financially secure than pure CLECs. Yet, as Table 4 demonstrates, a given reduction in net revenues would have a far more dire effect on this class of firms than on the S&P 500 or the ILECs generally.

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Table 4: Returns to Cable, Cellular and Interexchange Carriers in the S&P 500

Average Return Measure	_Decline in Net Revenue of:_				
	_0%_	_5%_	_10%_	_15%_	_20%_
EBT Margin	-18.5%	-24.7%	-31.6%	-39.4%	-48.1%
Return of Equity+Debt	2.7%	1.5%	0.2%	-1.0%	-2.2%
Return on Equity	-9.7%	-12.2%	-14.7%	-17.2%	-19.7%
EBITDA Margin	13.0%	8.5%	3.4%	-2.3%	-8.7%
EBIT Margin	-6.8%	-12.4%	-18.6%	-25.6%	-33.5%

Source: Compustat Database, Year-end 1999

19. Note the far greater leverage of this group vis à vis the more conservative financing of the S&P 500 as a whole, and the ILECs in particular. The difference between Earnings Before Taxes divided by Net Sales (EBT margin) and EBIT margin is Interest divided by Net Sales. Comparing Table 4 with Tables 2 and 3, shows that for the non-ILEC telecommunications carriers as a group, interest expense is, roughly, 12% of Net Sales. But when this same difference is calculated for the S&P 500 as a whole, interest expense is shown to be only about 4% of net sales; or when calculated for the ILECs only, about 5% of net sales. This greater leverage shows that these CLEC-surrogates are much weaker financially – and thus would be affected even more adversely by an overstatement of input prices – than the average firm in the S&P 500 Index.

III. AN OVERSTATEMENT OF UNE PRICES ABOVE TELRIC LEVELS WOULD LIKELY CUT-OFF RESIDENTIAL AND RURAL MARKETS FROM COMPETITION.

20. If all customer segments provided equal profit margins to a CLEC, an increase in input prices would be "dichotomous," that is, would have one of two effects: either the input price increase would be sufficient to prevent CLECs from providing local exchange

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service to any and all customer segments, or CLEC competitive service would continue to be available to all customer segments.

21.   In reality, however, all customer segments do not offer identical profit margins. Typically, some classes of customers offer revenue opportunities that vary greatly relative to the cost that must be incurred to serve these segments. For example, it is common for the share of revenues available from business customers to exceed the share of costs attributable to business customers. Conversely, the share of revenues available from residential customers may fall short of their share of costs.[13] Thus, differences in retail tariffs may make the profit margins available from business customers higher than the margins available from residential customers. Similarly, it is common for geographic differences in retail rates to fail to reflect fully the differences in cost associated with serving urban customers versus rural customers.[14] Thus, urban customer profit margins may exceed those available from rural customer segments.

22.   If profit margins differ across customer segments, the effect of an increase in a firm's input prices may not be dichotomous. In the face of an input price increase, a CLEC's optimal strategy may well be to curtail sales of its products to its lowest-margin customer segments, while continuing to offer service to higher-margin segments. For example, assume that there are two customer groups – business and residential customers – buying telephone services, with business customers purchasing $50 of telephone services per month, and residential customers purchasing $37 of telephone services per month. Assume further that the TELRIC of the purchased inputs required to serve a customer is $25, regardless of whether the

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[13] Of course, these mismatches between revenues and costs imply only that profit margins may differ across services and do not necessarily imply that residence service is unprofitable.

[14] Indeed, even though urban customers are less costly to serve than rural customers, it is common for rates in urban retail tariffs to *exceed* those in tariffs for rural service.

customer is business or residential. Thus, the net revenue available to a CLEC from a business customer is $25 ($50 - $25) and from a residential customer is $12 ($37 - $25). Assume, as well, that the CLEC's internal direct cost of serving each type of customer is $10 per month (a CLEC's internal direct costs may, in fact, be higher). In this scenario, the profit margin would be $15 ($25 - $10) from business customers but only $2 ($12 - $10) from residential customers. Because customers in each group provide a positive margin, the CLEC would serve both customer groups, although it is likely that the CLEC would focus its marketing efforts on the business segment, where the profit margin is higher.

23.   If, however, the price charged for purchased inputs in this scenario is increased by 20%, the cost of the purchased inputs required to serve business or residential customers rises to $30 (1.20 x $25). The result is a decreased, but still positive, profit margin of $10 from serving business customers, but a *negative* margin of $3 from serving residential customers. As a result, the CLEC will withdraw its service offer to residential customers. This is illustrated in Table 5, below.

Table 5: Customer Segments Differ in Revenues

CLEC Income Statement	Business Customers	Residential Customers
Revenues	$50	$37
Purchased input cost	$25	$25
Net revenue	$25	$12
CLEC internal direct cost	$10	$10
Profit margin available	$15	$2
Would segment be served by CLECs?	Yes	Yes
Purchased input cost @ 20% increase	$30	$30
Profit margin now available	$10	($3)
Would segment be served by CLECs?	Yes	No

24. In addition to differing in the revenues that are available from them, customer groups may differ in the costs incurred to serve them even if they pay the same retail rates. In local telephone markets, those cost differences are typically driven by differences in the loop costs of serving customers located in dense, metropolitan-type areas versus serving customers located in sparsely populated rural areas. For example, if a subset of business customers is remotely located, their higher loop costs would increase the cost of the purchased inputs required to serve them. Similarly, there may be a subset of residential customers located in urban areas (who may also live in multi-unit dwellings) whose purchased inputs are less expensive than those required to serve the average residential customer.

25. Assume, for example, that if a CLEC serves rural business customers, it faces purchased input costs of $35, or $10 higher than the business group average of $25. Similarly, assume that the purchased input costs of serving urban residential customers in multi-

unit dwellings is $20, or $5 less than the purchased input cost of $25 for the average residential customer. As Table 6 illustrates, in this scenario rural business customers would provide net revenues of $15 ($50 - $35). Because these revenues exceed the CLEC's internal direct cost of $10 and provides a profit margin of $5, rural business customers may be served along with nonrural business customers. Urban residential customers provide net revenues of $17 ($37 - $20), and will be served because this amount also exceeds the CLEC's direct internal cost of $10. However, service to non-urban residential customers would yield a *negative* profit margin of $3, because the net revenues of $7 ($37 - $30) would be below the CLEC's internal cost of $10. This is illustrated in the third column of Table 6. If the CLEC can direct its residential marketing strictly to customers that live in urban areas, it is optimal for the CLEC to serve only urban residential customers and to decline to serve non-urban residential customers.

Table 6: **Customer Segments Differ in Costs**

CLEC Income Statement	Rural Business Customers	Urban Residential Customers	Non-Urban Residential Customers
Revenues	$50	$37	$37
Purchased input cost	$35	$20	$30
Net revenue	$15	$17	$7
CLEC internal direct cost	$10	$10	$10
Profit margin available	$5	$7	($3)
Would segment be served by CLECs?	Yes	Yes	No
Purchased input cost @ 20% elevation	$42	$24	$36
Profit margin now available	($2)	$3	($9)
Would segment be served by CLECs?	No	Yes	No

26.   If purchased input prices are allowed to rise by 20% over TELRIC levels, even fewer customer segments would be served by CLECs, as Table 6 illustrates. Purchased input costs for rural business customers now become $42 (1.20 x $35), and the profit margin on CLEC sales to these customers drops to negative $2. In such circumstances, the CLEC would withdraw its service offering to rural business. The same 20% input price increase would increase total purchased input costs for urban residential customers to $24 (1.20 x $20). Because the profit margin received from these customers would be a positive $3, they might continue to receive service from CLECs. But for non-urban residential customers, a 20% increase in input

price would produce a further deterioration of gross margins, from negative $3 to negative $9.

Thus, non-urban residential customers would continue to receive no service from CLECs.

27. The fact that above-TELRIC pricing can result in entire customer segments being cut off from competitive entry is confirmed by actual data from Massachusetts. WorldCom has examined Verizon-Massachusetts' pricing of the UNEs needed to offer competitive local exchange and access services to residential customers. In Massachusetts, the prices charged by Verizon for these inputs are segmented into six zones: Metro, Urban Boston, Urban Other, Suburban Boston, Suburban Other, and Rural. Available per-line revenues (local service revenues plus exchange access and subscriber line charge revenues) are $30.99 in three of these zones, and $28.87 in the other three zones. Because unbundled loop rates rise as the zones become less dense, the total cost of the purchased inputs necessary for a CLEC to offer competing residential local and access services through the UNE Platform ranges from a low of $19.95 in the Metro zone, to a high of $32.54 in the Rural zone. Net revenues available to CLECs then range from $11.04 to a negative $3.67. If a CLEC's internal direct costs are, for example, $10.00 per customer (and, again, a CLEC's internal direct costs may, in fact, be higher), this suggests that the only residential customer segment that might be served by Massachusetts CLECs is the 2% of households that comprise the Metro zone – and it is far from certain that CLECs would choose to serve even that segment, in view of the high fixed costs of entry and the miniscule number of potential customers.[15] These figures are illustrated in Table 7.

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[15] *See* Joint Declaration of Paul Bobeczko and Vijetha Huffman (¶¶ 5-7 & Attachment 1) accompanying Comments of WorldCom, Inc. filed February 6, 2001 in CC Docket No. 01-9. WorldCom's analysis is consistent with a margin analysis which AT&T performed in connection with the Commission proceeding on Verizon's previous Section 271 application – and which AT&T has included with its comments in this proceeding. AT&T's analysis showed that CLECs contemplating Statewide entry at the current UNE prices in Massachusetts could only expect a *gross* margin (*i.e.*, the margin *before* any retailing or operational costs are recovered) of between

Table 7: Verizon-Massachusetts Residential Cost Analysis

CLEC Income Statement	Metro	Urban Boston	Urban Other	Suburban Boston	Suburban Other	Rural
Percent of households	2%	22%	6%	5%	58%	7%
Revenues	$30.99	$30.99	$28.87	$30.99	$28.87	$28.87
Purchased input cost	$19.95	$26.61	$26.61	$28.62	$28.62	$32.54
Net revenue	$11.04	$4.38	$2.26	$2.37	$0.25	($3.67)
CLEC internal direct cost	$10.00	$10.00	$10.00	$10.00	$10.00	$10.00
Profit margin available	$1.04	($5.62)	($7.74)	($7.63)	($9.75)	($13.67)
Would segment be served by CLECs?	Yes	No	No	No	No	No
TELRIC purchased input cost @ 40% decline	$11.97	$15.97	$15.97	$17.17	$17.17	$19.52
Profit margin now available	$19.02	$15.02	$12.90	$13.82	$11.70	$9.35)
Would segment be served by CLECs?	Yes	Yes	Yes	Yes	Yes	Yes

28.   AT&T and WorldCom have shown in their comments in this proceeding,

and in CC Docket No. 00-176, that if UNEs were priced at TELRIC in Massachusetts, UNE loop

prices would be at least 30% less than their current levels and UNE non-loop prices would be

more than 50% less than their current levels. The example in Table 7 demonstrates that if UNE

$1.52 and $3.78 per month, depending on the proportion of customers who choose a bundled versus "á la carte" set of local services. *See* Comments of AT&T Corp. filed February 6, 2001 in CC Docket No. 01-9, Attachment 2 (Declaration of Michael Lieberman, ¶ 20 & Exh. 1). Note, too, that CLECs will have other internal entry and retail costs in excess of their internal direct costs.
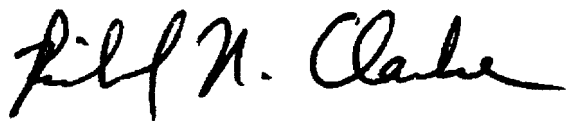
prices were in fact reduced by 40%, CLEC margins would improve significantly and CLECs might find it profitable to serve all residential customers in Massachusetts.[16]

IV.   CONCLUSION

29.   The foregoing analysis demonstrates that interconnection and UNE prices must be set at – rather than merely "close" to – TELRIC levels if CLECs are to have real and widespread opportunities to offer complete bundles of telecommunications services to their customers and to compete effectively in local telephone markets. Even small overstatements in these input prices almost certainly will ensure that CLECs will not enter (or will exit) the local exchange markets, and/or that very large segments of customers will be denied the benefits of competition.

30.   This concludes my Declaration.

I declare under penalty of perjury that the foregoing Declaration is true and correct.

Richard N. Clarke
Richard N. Clarke
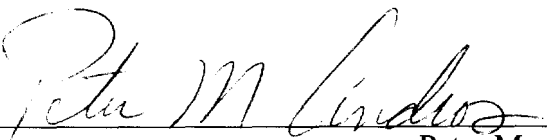
Executed on: February 28, 2001

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[16] Note that whether entry will actually occur will depend on the sum of the direct and indirect entry and retailing costs that the CLEC incurs.

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of February, 2001, I caused true and correct

copies of the forgoing Reply Comments of AT&T Corp. to be served on all parties by mailing,

postage prepaid to their addresses listed on the attached service list.

Dated: February 28, 2001
         Washington, D.C.

_____
                        Peter M. Andros

SERVICE LIST

Magalie R. Salas
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Room TW-B204
Washington, DC 20554

Susan Pie
Common Carrier Bureau
Federal Communications Commission
445 12th Street, SW
Room 5-C224
Washington, DC 20554

ITS, Inc.
1231 20th Street, NW
Washington, DC 20036

Donald J. Russell
David F. Smutny
Frances Marshall
Department of Justice
Telecommunications Task Force
1401 H Street, NW
Suite 8000
Washington, DC 20530

Luin Fitch
Ajit V. Pai
Department of Justice
Telecommunications Task Force
1401 H Street, NW
Suite 8000
Washington, DC 20530

W. Robert Majure
Mathew Magura
Department of Justice
Economic Regulatory Section
1401 H Street, NW
Suite 8000
Washington, DC 2053

Josh Walls
Department of Justice
Telecommunications Task Force
1401 H Street, NW
Suite 8000
Washington, DC 20530

Michael Glover
Karen Zacharia
Leslie A. Vial
Donna M. Epps
Verizon
1320 North Court House Road, 8th Floor
Arlington, VA 22201

Mark L. Evans
Evan T. Leo
Kellogg, Huber, Hansen, Todd & Evans
1615 M Street, NW, Suite 400
Washington, DC 20006

Cathy Carpino
Massachusetts Department of
  Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

Eric J. Branfman
Patrick J. Donovan
Harisha J. Bastiampilli
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW, Suite 300
Washington, D.C. 20007

Charles C. Hunter
Catherine M. Hannan
Hunter Communications Law Group
1620 I Street, NW, Suite 701
Washington, D.C. 20006

Jonathan Askin
Kimberly M. Kirby
The Association for the Local
 Telecommunications Services
888 17th Street, NW, Suite 900
Washington, D.C. 20006

Cathy Massey
XO Communications, Inc.
1730 Rhode Island Avenue, Suite 1000
Washington, D.C. 20036

Richard D. Metzger
Pamela Arluk
Focal Communications
7799 Leesburg Pike, Suite 850 N
Falls Church, VA 22043

Ronald L. Plesser
Vincent M. Paldini
Piper Marbury Rudnick & Wolfe LLP
1200 19th Street, NW
Washington, D.C. 20036

Robert J. Aamoth
Steven A. Augustino
Andrew M. Klein
Kelley Drye & Warren LLP
1200 19th Street, NW
Washington, D.C. 20036

Scott Sawyer
Vice President-Regulatory Affairs
Conversant Communications, LLC
222 Richmond Street, Suite 301
Providence, RI 02903

Charles B. Stockdale
Vice President and Corporate Counsel
Fiber Technologies, LLC
140 Allens Creek Road
Rochester, NY 14618

Danny E. Adams
Andrew M. Klein
Kelley Drye & Warren
1200 19th Street, NW
Washington, D.C. 20036

Christopher W. Savage
Karlyn D. Stanley
Erik J. Cecil
Cole, Raywid & Braverman, LLP
1919 Pennsylvania Avenue, NW
Suite 200
Washington, D.C. 20006

George B. Dean, Chief
Karlen J. Reed
Assistant Attorneys General
Regulated Industries Division
Public Protection Bureau
200 Portland Street, 4th Floor
Boston, MA 02114

Michelle Consalvo
Massachusetts Coalition for Competitive
 Phone Service
P.O. Box 5750
Boston, MA 02114

Rodney L. Joyce
Shook, Hardy & Bacon LLP
600 14th Street, NW, Suite 800
Washington, D.C. 20005-2004

William L. Fishman
Swidler Berlin Shereff Friedman LLP
3000 K Street, NW, Suite 300
Washington, D.C. 20007-5116

Kimberly A. Scardino
Rhythms Links, Inc.
1625 Massachusetts Avenue, NW
Washington, D.C. 20036

Sue D. Blumfield
A. Renee Callahan
Kelly McCollian
Wilkie Farr & Gallagher
Three Lafayette Center
1155 21st Street, NW
Washington, D.C. 20036

Stanley R. Kelly
The Telecommunications Advocacy Project
1211 11th Street, NW
Washington, D.C. 20001

Russel M. Blau
Patrick J. Donovan
Harisha J. Bastiampillai
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW, Suite 300
Washington, D.C. 20007

Mary L. Brown
Keith L. Seat
WorldCom, Inc.
1133 19th Street, NW
Washington, D.C. 20036

Jason D. Oxman
Covad Communications Company
600 14th Street, NW, Suite 750
Washington, D.C. 20005